Finding 11 - Employees and retirees are dropping dependent coverage under the indemnity plan, which threatens the viability of the medical plan

Significant drops have occurred in the percentage of employees covering dependents under the indemnity plan when employee coverage costs increase. Exhibit 3-24 shows the percentage of employees who are covering dependents. There was a 47 percent increase in the contribution level in 1987, a 16 percent increase in the contribution level in 1989, and a 38 percent increase in the contribution level in 1991, which negatively correlates to the trend of decreased employee dependent coverage.

The main reason for the drop in dependent coverage appears to be cost. Since 1991, based on an average annual salary of $24,000, coverage for children is $1,081 per year, or 4.5 percent of pay. Family coverage costs $2,594 per year or 10.8 percent of pay. To cover a spouse, an employee must enroll for family coverage. Clearly, the cost of coverage can become significant for an employee earning less than the average wage. Another reason for the indemnity plan losing dependents is employees opting for HMO coverage.

Given the recent contribution and claim history, changing demographics of the indemnity plan, and the current contribution methodology, dependent contributions in 1993 will need to be raised approximately 32 percent to maintain current benefit levels. This increase will require an employee electing family coverage to contribute 12.9 percent of his or her salary, based on a projected average salary of $26,500 in 1993. For an employee electing to cover his or her children only, the contribution level will be equal to 5.4 percent of pay. If employees react as they have in recent years, these increases in contribution levels will cause even more employees to drop dependent coverage.

Recommendation

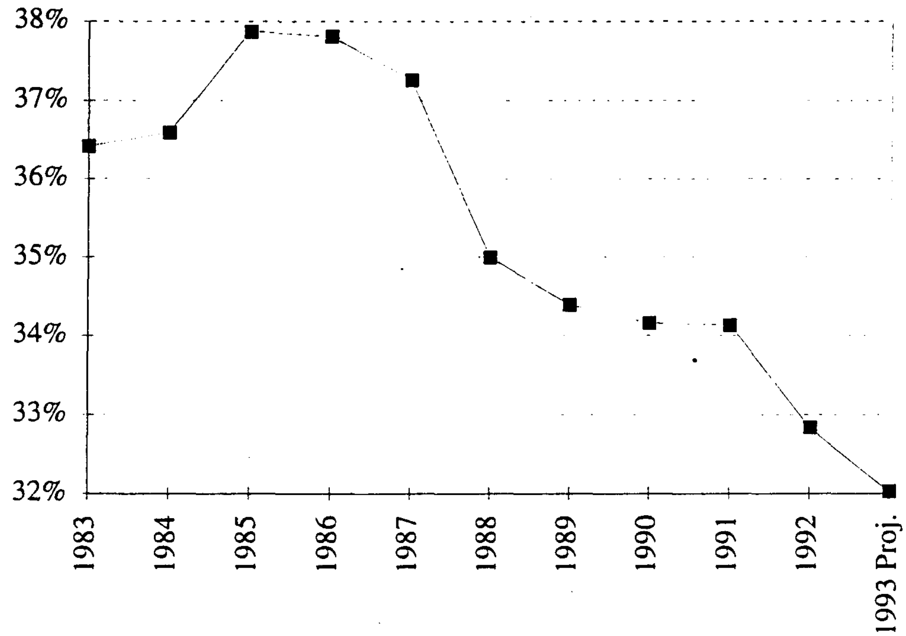
The State should conduct a study to determine the most appropriate contribution method. An equitable method should be found that will not increase the State's cost, yet will reduce the departure of dependents from the indemnity plan. One method to consider is to make contributions equal to a percentage of pay. Savings in the short-term are not expected with a change in the methodology, but a change is needed to maintain the ability of the State to continue offering employees an indemnity plan for their dependents.

Finding 12 - The State's benefits program lacks a comprehensive design that allows it to be tailored to employees' needs

Throughout the country, most organizations, both public and private, are working toward enhancing the flexibility of their benefit programs. Organizations are evaluating and providing a delivery system for all benefits provided to employees as a whole, including health, retirement, life and disability insurance, and paid time off. This is intended to:

- Increase the utilization of the various programs

Exhibit 3-24
Percentage of Employees Covering Dependents Under Indemnity Plan



Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost
Date: July 1991

- Enhance participants' understanding of the programs provided
- Help contain benefit costs

The State's benefits program lacks an ongoing comprehensive design that meets the diverse needs of its employees. This is illustrated in the current life insurance and long-term disability (LTD) program. The current program offered under the retirement program is not competitive in terms of life insurance and LTD coverage provided. Most employers offer employees life insurance equal to two times their annual compensation and LTD coverage within six months of employment. The State's current program provides life insurance equal to the annual salary up to $50,000, and LTD is only effective after the employee reaches five years of service. Thus, most employees must find additional LTD and life insurance coverage to provide adequate protection.

To meet these needs, the State allows employees to sign up for various benefit coverages offered by different vendors. Employees pay for these coverages through payroll deductions. Each agency is allowed to select its own vendor for these coverages. From an overall statewide perspective, the State does not know if the coverages offered are competitive in terms of cost or that the quality of the vendors meet State minimum requirements. Opportunities for coordination and cost savings exist in this area.

Recommendations

- Full flexible benefits (cafeteria plan) should be offered by the State. A cafeteria plan gives employees a fixed amount of benefit dollars to spend on a variety of types and levels of benefits. If the cost of the benefits selected exceeds the amount of the State's contributions, employees may contribute the remainder from tax-free dollars through a reimbursement account. Thus employees have wide latitude in tailoring benefits to fit their individual needs. The cafeteria plan menu typically includes:

    - Health
    - Life insurance
    - Disability insurance
    - Dental care
    - Vision care
    - Vacation time

    A cafeteria plan will provide the State a structure for managing the benefits program that allows employees to select the most appropriate coverage for them while capping the State's costs. A cafeteria plan also provides the State with a mechanism to evolve the benefits program over time instead of making significant changes every biennium. Also, because of the nature of flexible benefits, the benefits and associated costs will be analyzed every year. The State needs to conduct a study to determine changes needed in its current systems, employee communications, and benefit design to efficiently support and implement flexible benefits and maximize employee appreciation.

- The State should implement a comprehensive compensation and benefit program evaluation process. This comprehensive evaluation should be conducted annually and include a review of:

  - Benefit programs offered by other states and employers within the Southeast region.

  - Employer costs associated with benefit programs provided. Exhibit 3-25 presents our analysis of benefit program costs for eight southeastern state governments and the average U.S. private employer.

  - Benefit levels provided by the programs (i.e., life insurance equal to two times annual compensation).

  - Compensation program and respective salary levels.

  This evaluation should include health, retirement, payment for time not worked (i.e., vacations, holidays, sick leave, etc.), and salary levels. This evaluation should provide the information needed for the State to determine whether its total benefit package is competitive in relation to programs offered, benefit levels provided, and costs associated with providing employee benefits.

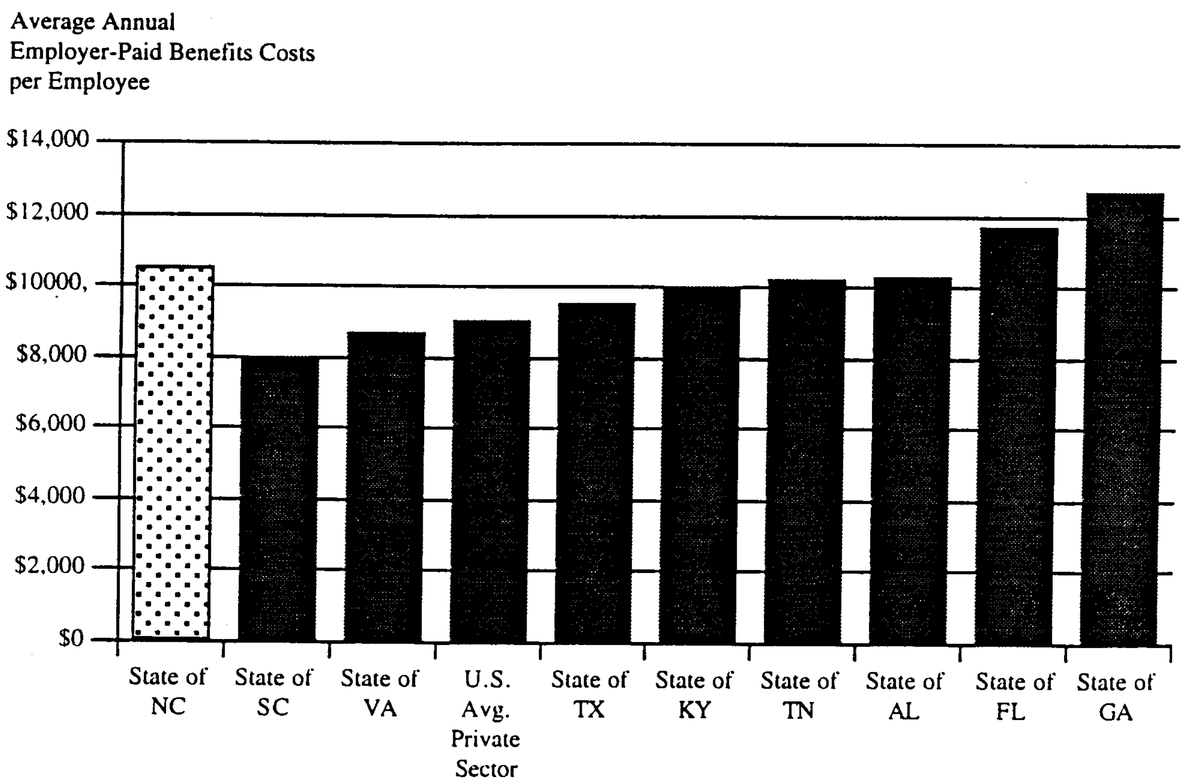
  The annual evaluation would provide the necessary information to determine a total benefits index. This index would enable the State to review its total compensation and benefits package in relation to compensation and benefits programs offered, compensation and benefit levels provided, and costs associated with providing employee pay and benefits by employers of similar scope and size as the State.

  The indexing exercise assigns a numeric value to the standardized middle of the market values for competitive compensation and benefits programs. The State can then review its own total compensation and benefits program and determine its similar standardized value. In this way, the State can measure incremental differences on a quantifiable basis between its own and the market's programs.

Finding 13 - The current contribution rates circumvent the intent of the law

Under the indemnity program, the current State law regarding employee contributions requires that the cost of retiree and employee coverage be 100 percent paid by the State. Dependents of employees and retirees are eligible for coverage **only on a fully contributory basis**, which means that retirees and employees must pay the full cost for their dependents' coverage.

Exhibit 3-25
Benefit Costs Analysis



Source: Fiscal Facts - 1991
Private Survey Conducted by KPMG Peat Marwick - 1992
U.S. Chamber of Commerce Employee Benefits - 1991 Edition

Exhibit 3-26 presents retiree health benefits eligibility and costs compared to other employers. We estimate that the State is overfunding the active and retiree coverage by $40,000,000 during the 1992 plan year. This overfunding is being used to subsidize dependent coverage. Exhibits 3-27 through 3-31 show that this funding of dependent coverage from State contributions for active employees has consistently occurred over the past few years.

- The total contributions for active employees (100 percent state funded) are almost always overstated and generate an annual surplus, as shown in Exhibit 3-26. This surplus is then used to subsidize the deficits in the other coverages (i.e., retirees and dependents) as well as to fund the indemnity program's reserves.

- The contributions that the State makes for retired employees are not sufficient to cover their claims (see Exhibit 3-28) because the State establishes its retiree contribution levels based on the contribution level set for active employees. As illustrated in the exhibits, the claim cost per retiree is higher than the claim cost per active employee. In 1983, retirees comprised 19 percent of the covered population. In 1991.this percentage had grown to 26 percent.

  The State currently provides the same contribution level for all retirees, regardless of the number of years of service they have with the State over and above five years. Retirees are the fastest growing, as well as the most expensive, segment of the covered population.

- Contribution amounts for active employees' dependents rarely equal the true cost of claims (see Exhibit 3-29). This is not in accordance with the State's law that dependents of employees are eligible for coverage only on a fully contributing basis.

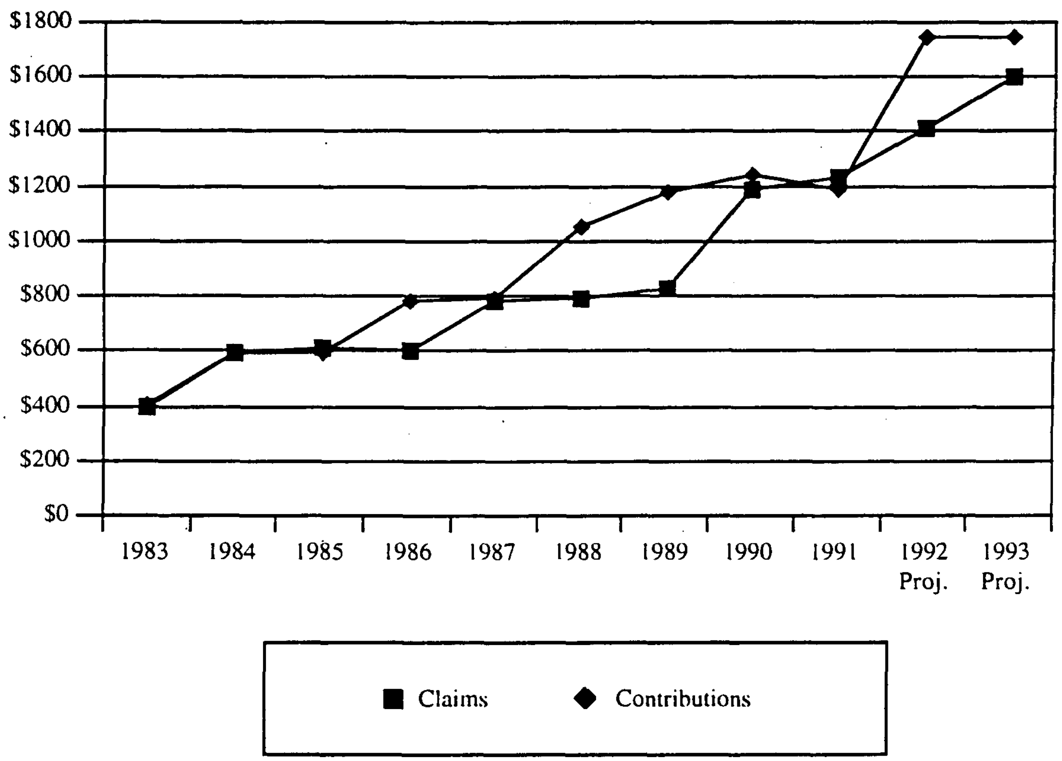
  One of the reasons for this lack of self-sufficiency is that each time the cost for dependent coverage increases, a large number of employees drop dependent coverage. The active employee and retiree dependents who remain in the indemnity program are those that believe they are most likely to have claims in excess of their contributions. Thus, the current contribution methodology is causing the indemnity program to retain those dependents with the highest claim costs. The dependents who leave take with them their contribution dollars without lowering the claim costs by the same amount. This creates an inflationary spiral that must be corrected to maintain an affordable dependent plan. (See Finding 11 of this report for more detail on this issue.)

- The contribution amounts for dependents of retirees are not sufficient to cover their claims, as shown in Exhibit 3-30. One of the reasons for this is that those retirees with dependents who are not eligible for Medicare enroll their dependents only when there is a known medical condition, which directly inflates the cost of the program.

EXHIBIT 3-26
RETIREE - HEALTH BENEFIT ELIGIBILITY AND COSTS

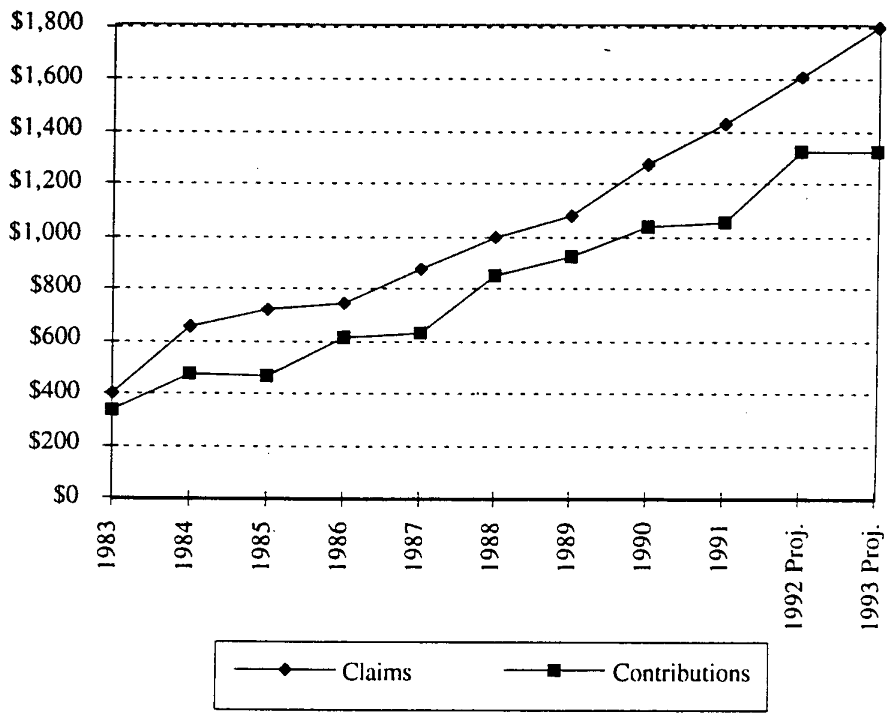
State of North Carolina	Other Employers
Pays all of retiree* only health benefit costs * State employees are eligible for retiree health benefits, regardless of age, after 5 years of service.	38% of states pay all of retiree health benefit costs 32% of states pay none of retiree health benefit costs Source: Martin Segal Study Date: 1991
State pays 100 percent of retiree only health benefit contributions - regardless of age Requires retiree contribution for dependent health benefit coverage - $2,594 for spouse under 65** - $1,972 for spouse over 65** ** under family plan	65% of all non-government employers require contributions from retirees less than 65 years old - $400 average per eligible employee - $1000 average per eligible employee and spouse 57% of all non-government employers require contributions from retirees greater than 65 years old - $225 average for eligible employee - $500 average for eligible employee and spouse Source: Wyatt Survey Date: 1990
State eligibility requirements for health benefits are less stringent than requirements for retirement benefits - 5 years of service and regardless of age State eligibility requirements for retirement benefits are - 5 yrs of service and 65 years old - 25 yrs of service and 60 years old - 30 years of service at any age	52% of all employers have eligibility requirements for employee health benefits that are the same as their retirement benefits 39% of all employers have eligibility requirements for employee health benefits that are more stringent than retirement benefits Average eligibility requirement is 10 years of service and 65 years old Source: Buck Benefit Design: A Delicate Balance Date: 1991

Exhibit 3-27
Total Contributions Versus Claims per Active Employee



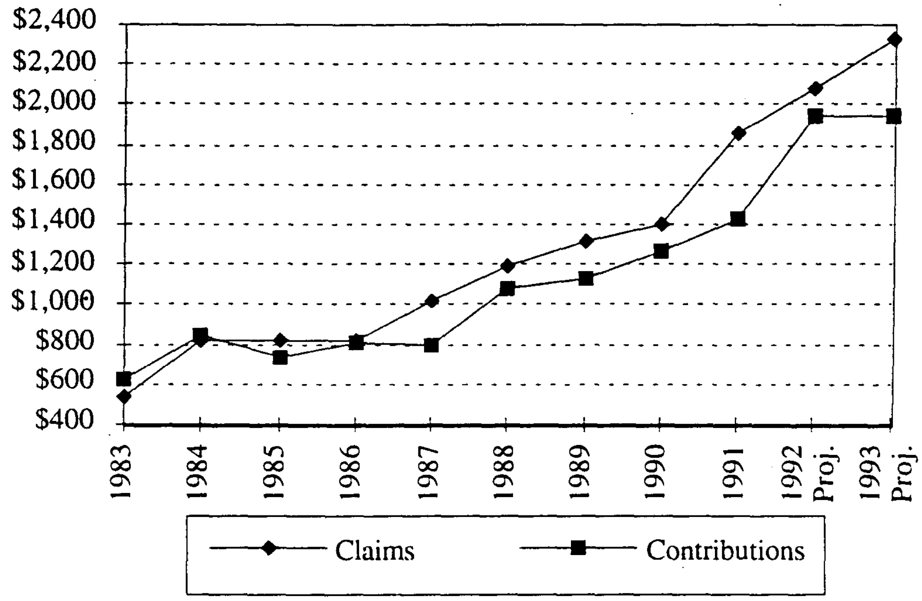
Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost
Date: July 1991

Exhibit 3-28
Total Contributions versus Claims per Retired Employee



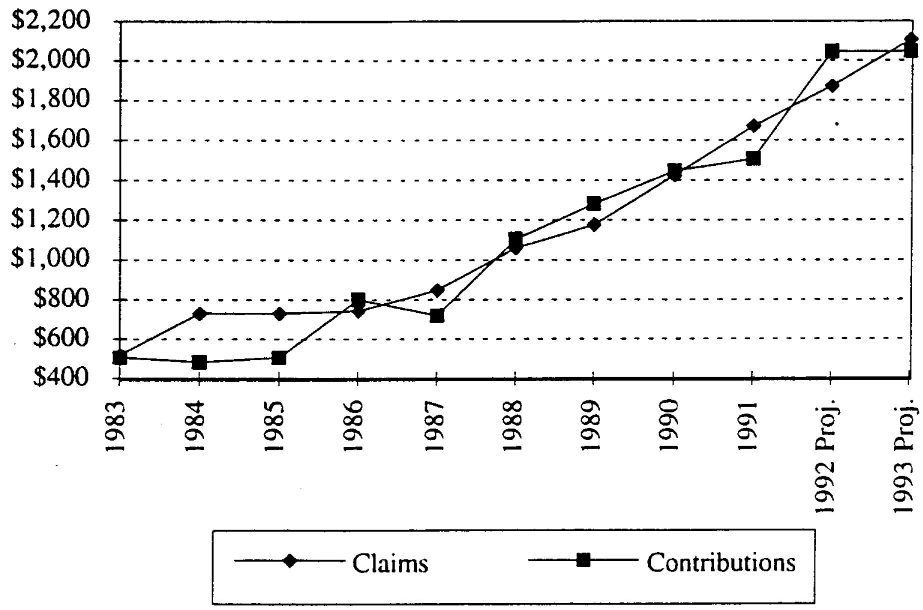
Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost
Date: July 1991

Exhibit 3-29
Total Contributions versus Claims per Dependent of Active Employees



Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost
Date: July 1991

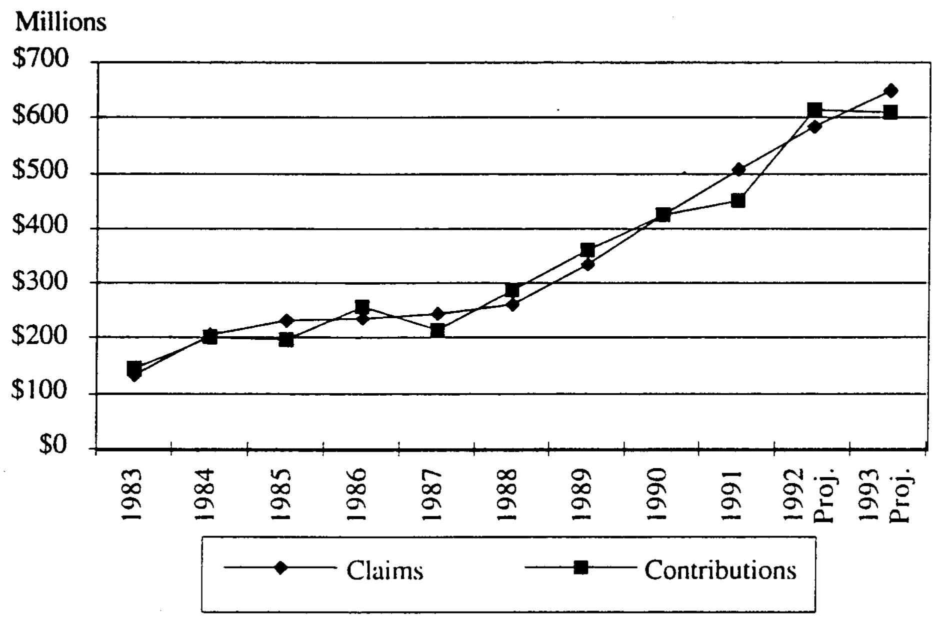
Exhibit 3-30
Total Contributions versus Claims per Dependent of Retired Employees



Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost

Date: July 1991

Exhibit 3-31
Total Contributions versus Claims
Indemnity Plan



Source: Fiscal Research Division's State of North Carolina Comprehensive Major Medical Plan for Teachers and State Employees Summary Analysis of Claims Cost

Date: July 1991

- Overall, the benefit program for active employees, retirees, and dependents has been fully funded, as shown in Exhibit 3-31. However, this funding level has been achieved by the State over-contributing for employee and retiree coverage. In 1991, the State had to use $50,000,000 of its reserves to pay all claims. This reserve had been built up over a period of previous years from surpluses on active employee coverage. Since the State pays 100 percent of the employee contributions for the indemnity program, the State is indirectly subsidizing the retiree and dependent coverage.

Recommendations

- The State should examine its practices with respect to the current law to see if the law allows contributions to be made for those identifiable segments of the employee population who are incurring the claims. The State should also determine if it can afford to continue to make the same contribution for retiree medical coverage for an employee who retires with 5 years of service compared to one who retires with 30 years of service.

- The State should analyze and set the contribution structure annually for each of the following significant groups that is covered under the medical plan:

  - Active employees
  - Dependents of active employees
  - Retired employees eligible for Medicare
  - Retired employees not eligible for Medicare
  - Disabled retired employees
  - Dependents of retired employees, eligible for Medicare
  - Dependents of retired employees, not eligible for Medicare

- The State should determine a contribution philosophy for each group covered under the plan and begin to implement that philosophy as soon as possible. The State's contribution philosophy should take into account:

  - Number of rate tiers
  - Future employment and retirement patterns
  - Employees' ability to pay
  - Length of service
  - Benefits indexing

Finding 14 - The administration of the employee pension program is fragmented

The State currently sponsors five defined benefit pension plans covering various groups of employees. The plans are funded by both employee and employer contributions. The five plans are:

- Teachers' and State Employees' Retirement System
- National Guard Retirement System
- Legislative Retirement System
- Firemens' and Rescue Squad Workers' Pension Fund
- Consolidated Judicial Retirement System

The State Treasurer's Office currently administers all but one of the State retirement programs. The Firemen's and Rescue Squad Workers' Retirement Plan is administered by the State Auditor's Office.

Recommendation

The administration of the Firemens' and Rescue Squad Workers' Retirement Plan should be transferred to the State Treasurer's Office which administers all other defined benefit pension plans sponsored by the State. This will increase efficiencies of administration established at the State Treasurer's Office.

The transition process needs to be defined to consider the orderly assumption of the administrative responsibilities by the Treasurer's Office. This transition process must include an understanding of:

- Administrative tasks currently performed
- System compatibilities and capabilities
- Staffing needs

Training and development

Employee training within the State is not comprehensively planned, coordinated, or monitored. The findings that support this conclusion are:

- The State of North Carolina does not effectively monitor its training and development expenditures, nor does it monitor the use of training throughout the State.

- The State of North Carolina does not consistently coordinate its training efforts across the branches of government or across agencies.

These findings and our recommendations are discussed in detail below.

Finding 15 - The State of North Carolina does not effectively monitor its training and development expenditures, nor does it monitor the use of training throughout the State

The State was unable to provide Peat Marwick with an estimate of the amount of money spent on training and development, because there is no mechanism in place to monitor these costs. This lack of monitoring is highly unusual. Most private sector organizations and several states have some mechanism in place to monitor these costs. Exhibit 3-32 shows a comparison of dollars spent on training in relation to payroll among the Fortune 500, the federal government, the state of New Jersey, and the state of Florida.

Research into the budget line item expenditure (object code 3950) for the Employee Educational Expense program revealed that the State had an 11 percent decrease in dollars expended between June 30, 1990 and June 30, 1991. Between June 30, 1991 and March 20, 1992, there was a 24 percent decrease in dollars expended. These figures were the only employee training-related expenditures to which we had access and it suggests that the State is decreasing its investment in employee training.

Monitoring the dollars spent on training and development can assist the State in two significant ways:

- It can help the State determine the percentage of payroll being invested in employee training to evaluate its competitiveness.

- It will position the State for economies of scale where there is duplication of training expenditures and/or efforts.

Recommendation

The State needs to establish a system to monitor the costs associated with its investment in the training and development of its employees. The ability to monitor and track training costs is the first step necessary in developing a cost-effective strategy for procuring appropriate training and development courses. Training costs monitored should encompass all costs related to training including the salaries of trainers, supplies and materials, facility costs, and the fee charged for the course. A logical point of data collection for these types of expenditures is within the State's Budget System.